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August 11, 2003

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ex Parte

Marlene H Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No 96-149

Dear Ms. Dortch:

Verizon has already demonstrated that its petition for forbearance from the prohibition of sharing operating, installation, and maintenance ("OI&M") services between the Verizon BOCs and their section 272 affiliates is in the public interest. AT&T's July 9 *ex parte* letters repeat many of its previous criticisms and they completely fail to refute the public policy and legal rationale for Commission approval of Verizon's petition Indeed, Verizon has already responded to most of AT&T's arguments in its previous filings This filing responds to a few additional AT&T arguments that are equally without merit.

Despite Verizon's repeated explanations of its costing methodology, AT&T continues to misconstrue Verizon's cost study submitted in support of the forbearance petition. AT&T incorrectly claims that Verizon assumed that the BOCs have excess capacity in their OI&M workforce and would incur no incremental costs to provide OI&M services to their section 272 affiliates Based on this mischaracterization, AT&T claims that Verizon would not comply with the Commission's cost allocation rules in allocating costs between its regulated and non-regulated services. In fact, Verizon made no such assumption. Its cost study includes a reasonable estimate of the incremental costs that the BOCs would incur to provide OI&M services to the section 272 affiliates These costs are lower than the costs that the section 272 affiliates currently incur due to the greater economies of scale that the BOCs enjoy as compared to the section 272 affiliates The study confirms the Commission's repeated findings that separate affiliate

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requirements impose substantial cost burdens that could be avoided through integrated operations

1. **Verizon has not assumed that the BOCs would "absorb" the OI&M work for the section 272 affiliates without incurring additional costs.**

AT&T argues (Selwyn Decl , ¶¶ 11-13) that Verizon's cost study is based on an "absorption" theory that is contrary to TELRIC-based pricing because it assumes that the BOC would provide OI&M services to the section 272 affiliate using idle BOC personnel at essentially zero incremental cost AT&T claims that this is a short-run marginal cost approach that would produce transfer prices to the section 272 affiliate below the BOC's long run cost of providing OI&M services There are two fundamental flaws in this argument. First, TELRIC costing principles, which the Commission adopted for the pricing of unbundled network elements under section 252 of the Act, have no relevance to the pricing of access services or to the affiliate cost allocation rules, which are based on fully distributed cost principles Second, Verizon did not assume that the BOCs have excess capacity or that the costs of providing OI&M service would be zero, as AT&T claims Rather, the OI&M costs that Verizon shows in its study as *not* being saved are primarily the costs that the BOC would incur to provide these services to the section 272 affiliate These are long-run costs, not short run. They are lower than the costs that the section 272 affiliate currently incurs, because the BOCs could provide these services more efficiently due to their much greater economies of scale as compared to the small OI&M forces employed by the section 272 affiliates.

For instance, there would be no need for a separate section 272 maintenance work group if the BOCs could perform maintenance for both themselves and for the section 272 affiliates. Verizon estimated that the BOCs could perform the maintenance function by adding expenses equal to only 70 percent of the costs that the section 272 affiliates currently incur due to the much greater economies of scale enjoyed by the BOCs The section 272 affiliates cannot operate as efficiently as the BOCs, because they must assign dedicated personnel to be available for installation, maintenance and repair of facilities even if these personnel are not fully utilized. In addition, since it would be impractical for the section 272 affiliates to deploy a field force and supporting assets, such as trucks and other equipment, to install and repair the relatively small amount of outside plant, they must rely upon more costly independent contractors for the outside plant function on an as-needed basis Use of the BOC field force would allow the section 272 affiliates to replace the use of outside vendors for this purpose and avoid most of these costs (categorized as "professional services")

For the same reasons, AT&T is incorrect in claiming (Selwyn Decl , ¶¶ 14, 18-19) that Verizon would violate the Commission's Part 64 cost allocation rules by failing to allocate BOC OI&M expenses to the section 272 affiliates at fully distributed cost AT&T assumes that the BOCs would allocate next to nothing to nonregulated accounts for these OI&M services. This is incorrect. As Verizon explained in its June 24 *ex parte* filing, if the Commission granted OI&M forbearance, Verizon would file Cost Allocation Manual ("CAM") changes to capture these costs, using time reporting codes and new non-regulated cost pools as necessary. *See* June 24 *ex parte*, 4-5 Similarly, AT&T's assumption (Selwyn Decl , ¶ 18) that Verizon would engage in "non-zero" allocations of costs of investment used jointly for regulated and non-regulated activities is baseless Such investments would be allocated using fully-distributed cost principles based on relative use

2. **Verizon would have no incentive to misallocate OI&M costs to the BOCs.**

AT&T alleges (Selwyn Decl., ¶ 7, *see also* AT&T Opposition, Selwyn Decl., ¶ 35) that Verizon has several incentives, even under a pure price cap regime, to misallocate costs to the BOC and to artificially lower the section 272 affiliate's costs However, these arguments are based on the incorrect assumption that Verizon's cost study is based on substantial excess workforce at the BOC that could be made available to the section 272 affiliate at little or no cost. As Verizon explained above, this just is not so Verizon did not assume idle hands at the BOC. It simply took advantage of the greater economies of scale and efficiencies that the BOC could bring to bear in providing these services to the section 272 affiliates as opposed to the costs that are currently incurred by the section 272 affiliates in maintaining small, dedicated workforces. Consequently, AT&T's assumption that the BOC has "large quantities of excess or spare capacity" that are inflating the BOCs' costs for regulated service is wrong. The incremental cost that the BOCs incur to provide OI&M services to a section 272 affiliate will be charged to that affiliate on a fully distributed cost basis

AT&T provides three examples to support its claim that Verizon has an incentive to misallocate costs even under price caps None of these makes any sense. First, AT&T argues that the BOC spare capacity costs could be used to justify higher prices for "bottleneck" services such as access and UNEs. However, access service prices were initialized in 1990 and have been adjusted ever since by a price cap formula using "X-factors" and inflation adjustments that are indifferent to the price cap carrier's actual costs The 1990 rates were established under rate of return after a thorough review by the Commission. There is no evidence that these rates were inflated by "excess capacity " With regard to UNEs, those rates are set using the "TELRIC" methodology, which is based on hypothetical costs rather than on Verizon's actual costs. Second, AT&T argues that shifting costs to the regulated operation lowers the long distance affiliate's costs and makes it easier for the affiliate to compete with "downstream" rivals, presumably because the affiliate would not pay the full cost of the BOC's OI&M services. But Section 272(c) would require the BOC to make these services available to unaffiliated carriers under the same terms and conditions, making the same efficiencies available to the rivals as well Therefore, there is no way that the BOC could give an unfair competitive advantage to its section 272 affiliates Allowing such sharing would put Verizon's affiliated long distance carriers on the same footing as other long distance providers, who may provide local and long distance service using a single workforce Third, AT&T argues that shifting costs to the BOC would allow it to maintain or increase its access charges once the CALLS freeze has expired, or if access charges are reinitialized for a state price cap plan This is pure speculation. In the CALLS proceeding, the Commission extended for five years the market-based approach that it adopted in the access charge reform proceeding *See Access Charge Reform*, 15 FCC Rcd 12962, ¶ 60 (2000) AT&T provides no support for the proposition that the Commission will undo its own reforms at the end of the CALLS transitional period More fundamentally, the speculation that this Commission or a state commission may alter their regulatory regime is far too attenuated for it to gain any credibility for AT&T's well-worn (but never substantiated) claims of cost misallocation.[1] Moreover, the additional competition from wireline carriers as well as from alternative platforms such as cable and wireless eliminate any ability of the BOCs to raise rates for local or exchange access services unreasonably, even if the regulators were to allow such changes.

3. The Verizon BOC would provide OI&M services to unaffiliated entities on a non-discriminatory basis.

AT&T argues (Selwyn Decl , ¶ 21) that Verizon would violate the nondiscrimination requirements of section 272(c) of the Act by providing the efficiency gains of OI&M services only to its section 272 affiliates. This simply is not true The BOC charges for OI&M services to the section 272 affiliates would be the "prevailing price" that would also be offered to non-affiliated companies *See* 47 C.F R § 32 27(d). Section 272(b)(5) of the Act and section 53 203(e) of the Commission's rules require the BOCs to develop arms-length, written contracts with their section 272 affiliates and to make those contracts available for public inspection The same services, at the same prices, will be available to third parties For example, the Verizon BOCs currently provide billing and collection services to their section 272 affiliates as well as to non-affiliated long distance carriers on a non-discriminatory basis

4. Verizon has explained and justified the basis for its estimates of the percentages of each OI&M expense category that it could save through forbearance.

AT&T repeats its previous arguments (Selwyn Decl , ¶ 4) that Verizon has not justified its estimates of the percentages of each OI&M expense category that it could save through forbearance by having the BOCs provide OI&M services to the section 272 affiliates. AT&T complains that it cannot reproduce these percentages and that Verizon has not produced facts by which these percentages were calculated. These criticisms are not valid By necessity, these estimates are based on the expert judgment of the Verizon subject matter experts in each field. *See* Attachment, ¶ 3. Verizon currently operates under the OI&M restrictions, and its detailed financial data accounting works within that regime. In order to provide the Commission with additional information about the order of magnitude of the harm caused by these restrictions, Verizon asked the subject matter experts in the section 272 affiliates to estimate the costs that would have been incurred if they had been able to ask the BOCs to perform the OI&M services

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[1] Like the Commission, the vast majority of states have adopted price cap approaches *See* Communications Daily, Retail Rate Regulation of Local Exchange Providers in the U S , A Special White Paper Supplement to Communications Daily (June 20, 2003) This white paper describes the type of price cap or incentive regulation that Verizon faces in each of its in-region states The Commission should note that in Indiana, where the report states that Verizon's rates are under non-indexed price caps, Verizon's rates are still subject to rate-of-return regulation but Verizon recently proposed an alternative form of regulation

rather than to develop a separate workforce or hire outside contractors *See* June 24 *ex parte* at 7 The subject matter experts also estimated the future timetable for transitioning from a separate workforce to use of BOC personnel for OI&M work This transition estimate was the basis for Verizon's estimate that it could save $183 million through 2006 if the forbearance petition were granted *See* June 4 *ex parte*, Attachment 3 at 5, Attachment 4 at 2. The use of such expert testimony is common in Commission proceedings, and Verizon has provided detailed information about how that testimony was used to derive the estimated cost savings. The fact that the estimates were based on expert judgment does not make them any less reliable

Regardless of the exact level of the savings that Verizon would achieve by eliminating duplicative OI&M workforces at both the BOCs and the section 272 affiliates, it is undeniable that separate affiliate requirements impose significant additional costs. The Commission has found that this is so on numerous occasions For instance, in removing the separate affiliate requirement for the provision of enhanced services, the Commission found that "the structural separation requirements impose significant costs on the public in decreased efficiency and innovation that substantially outweigh their benefits in limiting the ability of AT&T and the BOCs to make unfair use of their regulated operations for the benefit of their unregulated, enhanced services activities." *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, 104 F C C.2d 958, ¶ 3 (1986).

AT&T claims (at 5-8) that the Commission has found that the benefits of separate affiliates outweigh the costs where the BOCs have control of essential facilities necessary for competition This is revisionist history AT&T cites the Commission's initial decision to require the BOCs to use separate affiliates to offer customer premises equipment ("CPE"), but it conveniently neglects to mention the Commission's decision a few years later to *eliminate* this requirement *See Furnishing of Customer Premises Equipment by the Bell Operating Telephone Companies and the Independent Telephone Companies*, 2 FCC Rcd 143 (1987). In doing so, the Commission specifically found that,

> structural separation requirements impose substantially greater costs on carriers and ratepayers than nonstructural safeguards. . the loss of possible efficiencies here because of mandatory structural separation results in higher prices and reduced quality and variety of regulated services provided to ratepayers by carriers. These requirements also prevent the BOCs from satisfactorily serving customers that desire integrated telecommunications systems solutions and designs [2]

These findings confirm Verizon's demonstration that the OI&M restriction imposes substantial costs on Verizon's provision of long distance services.

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[2] Id , ¶ 29 (footnotes omitted)

have made it clear that an agency cannot refuse to follow congressional mandates based on doubts about their constitutionality *See, e.g., Johnson, Administrator Of Veterans' Affairs, et al v. Robison*, 415 U S 361, 368 (1974) ('adjudication of the constitutionality of congressional enactments has generally been thought beyond the jurisdiction of administrative agencies"); *Meredith Corp v. FCC*, 809 F 2d 863, 872 (D C Cir 1987) ("regulatory agencies are not free to declare an act of Congress unconstitutional") Only the courts may address the constitutionality of the Act

Sincerely,

Attachment

cc J Carlisle
M Carey
B Olson
R Tanner
W Dever
R Kaufman
C Rand
M Stephens
P. Megna

ATTACHMENT

Supplemental Declaration of Fred Howard

1 My name is Fred Howard I am the President of Verizon Global Networks Inc (GNI) I previously submitted a declaration in support of Verizon's August 5, 2002 petition for forbearance from the prohibition of sharing operating, installation and maintenance (OI&M) services between a Bell Operating Company and a section 272 separate affiliate (CC Docket 96-149). Information regarding my background and responsibilities are detailed in the August 5, 2002 declaration.

2 My responsibilities still include the oversight of the activities to support GNI's input to Verizon's OI&M petition In this regard, I have first-hand knowledge of the content of the cost/savings data and of the analysis provided by Verizon in its *ex parte* filings in this proceeding, including the following·

- May 12, 2003 – the historic data underlying Verizon's study of the costs of complying with the section 272 separate affiliate rules.
- June 4, 2003 –the detailed narrative of Verizon's method of calculating the going-forward savings in Attachment 3, and the historic cost data and the projected cost data in Attachment 4.
- June 24, 2003 – the OI&M functions used for expense categorization (section 1), the assumptions underlying estimates of incremental operating expenses driven by structural separations (section 4), the assumptions underlying GNI's projected expenditures for 2003-2006 period (section 5), the assumptions underlying estimates of the projected cost savings for 2003-2006 from the elimination of

structural separations (section 6), and the costs of reintegrating the OI&M functions of GNI and the Verizon local exchange carriers (section 7).

These filings were prepared under my direction and control, and I affirm that they accurately represent the basis for and procedures used in Verizon's cost study

3 AT&T complains (Selwyn Decl , ¶ 4) that it cannot reproduce the percentages that Verizon used in the cost study and that Verizon has not produced the facts by which these percentages were calculated These criticisms are not valid Since Verizon's current business plan and budget are based on the existing regulations, in preparing our estimates for cost savings associated with FCC forbearance of the OI&M restrictions, GNI relied on a review by GNI subject matter experts to determine the savings that could be achieved in the absence of the OI&M restriction. Verizon asked the subject matter experts in each job function to estimate the costs that would have been incurred if they had been able to ask the BOCs to perform the OI&M services rather than to develop a separate workforce or hire outside contractors. This process is described in the June 24 *ex parte* at 7-9. The subject matter experts also estimated the future timetable for transitioning from a separate workforce to use of BOC personnel for OI&M work. This is described in the June 24 *ex parte* at 11-12 This transition estimate was the basis for Verizon's estimate that it could save $183 million through 2006 if the forbearance petition were granted *See* June 4 *ex parte*, Attachment 3 at 5, Attachment 4 at 2. The fact that the estimates were based on expert judgment does not make them unreliable Verizon has provided detailed information about how the estimates were developed and how they related to the operational characteristics of each function For instance, Professional Services expenses consist primarily of field forces and contract employees

that were hired by GNI because it did not have the ability to hire employees with the required skill sets quickly enough as demand grew and because it did not have enough outside plant facilities to justify a dedicated field force This over-dependence on vendor-supplied labor would not have been necessary if Verizon could have used BOC personnel, which had both the necessary skill sets as well as the ubiquitous presence to perform OI&M services for GNI on an as-needed basis. These factors fully explained the much higher percentage of savings that GNI could achieve in the Professional Services category as compared, for instance, to the Force and Employee-Related category.

4 AT&T also complains that Verizon's analysis does not indicate that the Verizon BOC OI&M experts were consulted. (*See* AT&T July 9, 2003 Ex Parte, Declaration of Lee Selwyn at ¶ 5.) As I explained in my August 5, 2002 declaration, the purpose of the analysis was to develop estimates of the costs that GNI has incurred and anticipates to incur to comply with the Commission's separate affiliate rules Verizon's June 24, 2003 *ex parte* (section 4) described the study team that developed those estimates, which consisted of GNI subject matter experts representing Operations, Information Technology, Engineering, Business Services and Finance. These experts are very familiar with the BOC's operations and are capable of determining the type of OI&M support they could obtain They are also capable of determining how much more efficiently these services can be provided through the large and ubiquitous BOC workforce compared to the relatively small number of GNI personnel Although the Verizon petition was reviewed by BOC representatives, it was not necessary to include BOC operational personnel in the development of the cost study, because the study did not rely on an analysis of the current BOC workforce utilization. Rather, it was based on

functional knowledge of BOC operations and capabilities to determine the ability of the BOC to provide the necessary OI&M services to GNI.

5 AT&T's criticism on this point is based on its belief that Verizon assumed that the BOC could provide OI&M services to GNI at *no* additional cost – *i.e.*, that the BOC is working inefficiently and that it would provide OI&M services using workers that are currently idle. *See, e.g.*, Selwyn Decl., ¶¶ 9-13. This simply is not true Verizon did not assume that the BOC is saddled with under-utilized personnel and that GNI could reduce its expenses without any increase in BOC costs. Rather, Verizon assumed that the increase in BOC costs, which would be charged to GNI under the affiliate transaction rules, would be significantly less than the costs that GNI currently incurs using a stand-alone workforce, because this workforce cannot be utilized as efficiently as the BOC's much larger workforce For instance, Verizon estimated that GNI's budget for Workforce and Empoyee Related expenses would be only 70 percent of the current level if those functions were provided by the BOC and billed to GNI by the BOC, including replacement of almost all of the work that GNI contracts today to outside vendors in the category of Professional Services expenses. The assumption was that the BOC could perform these services more efficiently because its vastly larger workforce could handle additional jobs for GNI without having to dedicate employees specifically to GNI facilities as GNI does today GNI must have employees or contractors available for installation, repair and maintenance even if they are not fully utilized due to the limited amount of switching and transmission facilities that GNI owns. By purchasing OI&M services from the BOC, GNI could take advantage of the BOC's economies of

ATTACHMENT

scale and scope These economies are shown in the net reduction in GNI's projected budget with OI&M relief.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct to the best of my knowledge and belief

Executed on August 11, 2003

Fred R. Howard
Fred Howard

Ann D. Berkowitz
Project Manager – Federal Affairs

verizon

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October 1, 2003

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149 and *Verizon Petition for Forbearance*, CC Docket No. 01-338; *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98; *and Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147

Dear Ms. Dortch:

Today, Dee May and Ed Shakin represented Verizon in a meeting with Chris Libertelli of Chairman Powell's office, during which they discussed the continuing need for the relief requested in the above Petitions. The positions presented by Verizon were consistent with those filed in the record, specifically the attached document represents Verizon's positions in the OI&M Petition.

Also discussed was the Joint Petition for Stay Pending Judicial Review filed by BellSouth, Qwest, SBC, USTA and Verizon filed on September 4, 2003 and the need for clarity with respect to the broadband section of the August 21, 2003 Report and Order and Order on Remand and Further Notice of Proposed Rulemaking in the above proceeding as well as the impact of the EELs decision.

Please feel free to call me if you have any questions.

Sincerely,

Ann D Berkowitz

Attachment

cc:	C. Libertelli	J. Dygert
	B. Tramont	J. Stanley
	M. Brill	W. Maher
	D. Gonzalez	J. Carlisle
	J. Rosenworcel	M. Carey
	L. Zaina	B. Olson
	J. Rogovin	B. Dever

Section 10(d) Does Not Limit the Commission's Authority To Forbear From Its OI&M Regulations

For purposes of convenience, this paper briefly summarizes the several reasons that section 10(d) of the 1996 Act does not bar the Commission from granting Verizon's petition to forbear from applying the rule prohibiting the sharing of operating, installation and maintenance services ("OI&M" rule).

1. First and foremost, section 10(d)'s narrow limitation on the Commission's broad forbearance authority does not apply here because the prohibition against sharing of OI&M services is not required by the Act but is instead a creation of the Commission's own rules.

a. By its terms, section 10(d) temporarily limits the Commission's authority to forbear from applying two specific provisions of the Act, sections 251(c) and 271. While some parties have argued that section 10(d) should be read to also incorporate another provision of the Act *sub silencio* – namely, section 272 – the outcome of that debate is immaterial to the issue presented here. This is so for the simple reason that, however it is construed, section 10(d) limits the Commission's authority to forbear only with respect to "requirements" of the Act itself. And, as the Commission itself has held, the prohibition against sharing of OI&M services is *not* required by section 272 of the Act, but was instead adopted by the Commission in a discretionary exercise of its rulemaking authority.

b. Specifically, the OI&M rule was adopted by the Commission as part of its rules implementing section 272(b)(1), which provides only that a Bell company's long distance affiliate should "operate independently." Both at the time the rule was adopted and since, the Commission has expressly recognized that the general language of section 272(b)(1) does not "require" it to adopt any specific restriction and does not "require" it to prohibit the sharing of

OI&M services in particular. Rather, the Commission has concluded that section 272(b)(1) is ambiguous, and has interpreted that provision to provide the Commission with discretion to adopt rules based on a balancing of competing policy objectives. Accordingly, the OI&M rule simply reflects the Commission's assessment of the proper balance of the risks and benefits that it saw at the time the rule was adopted – an assessment that the Commission can and should revisit now.

As an initial matter, the Commission has expressly held that "there is no plain or ordinary meaning" of section 272(b)(1)'s "operate independently" requirement "that compels us to adopt a particular set of restrictions." *Non-Accounting Safeguards Reconsideration Order* ¶ 14.[1/] On the contrary, the Commission held that the phrase "operate independently" is not "self-executing" but rather is an "ambiguous" phrase that the Commission has full "discretion to interpret." *Id.* Indeed, as the Commission has pointed out, even AT&T and its fellow long distance carriers have conceded as much. *Id.*

Because the statute did not "require" any particular restriction, the Commission decided to exercise its discretionary rulemaking authority by "balancing" competing policy interests underlying section 272 in order to adopt implementing rules. Specifically, the Commission sought to fashion rules that "strike an appropriate balance between allowing the BOCs to achieve

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1/ Third Order on Reconsideration, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended,* 1999 WL 781649, ¶ 14 (1999) (*"Non-Accounting Safeguards Reconsideration Order"*). The Commission likewise found that "there is no 'precedent' in the Commission's rules that defines the term 'operate independently' as used in section 272(b)." *Id.* ¶ 17.

efficiencies within their corporate structures and protecting ratepayers against improper cost allocation and competitors against discrimination."[2]

Significantly, in balancing these policy interests, the Commission expressly "decline[d] to read the 'operate independently' requirement to impose a prohibition on all shared services," holding that "the economic benefits to consumers from allowing a BOC and its 272 affiliate to derive the economies of scale and scope inherent in the integration of some services outweigh any potential for competitive harm created thereby." *Non-Accounting Safeguards Order* ¶ 168; *see also Non-Accounting Safeguards Reconsideration Order* ¶ 15. The Commission decided that in many respects this balance tipped in favor of permitting sharing. Thus, for example, the Commission permitted BOCs and their section 272 affiliates to share administrative and marketing services and to engage in joint research and development. *Non-Accounting Safeguards Order* ¶¶ 168-69; *see also* 47 C.F.R. § 53.203(a); *Non-Accounting Safeguards Reconsideration Order* ¶¶ 15, 18.

Likewise, just as the Commission recognized that the statute does not prohibit the sharing of services generally, it also recognized that it does not prohibit the sharing of OI&M services in particular. Accordingly, the Commission's rules expressly permitted OI&M services to be shared under various circumstances. For example, the Commission expressly permitted BOCs to contract with affiliates to perform OI&M services in connection with any unbundled network elements purchased by the affiliate; likewise, it expressly allowed the affiliates to perform OI&M

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[2] First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended,* 11 FCC Rcd 21905, ¶ 167 (1996) ("*Non-Accounting Safeguards Order*"); *see also Non-Accounting Safeguards Reconsideration Order* ¶¶ 15-18.

services in connection with any sophisticated equipment that the BOC purchases from the affiliate. *Non-Accounting Safeguards Order* ¶ 164; 47 C.F.R. § 53.203(a).

Moreover, even though the Commission decided to restrict the sharing of OI&M services in other circumstances, it again did *not* conclude that such sharing would itself violate section 272(b)(1). Rather, the Commission found that sharing OI&M services in certain circumstances could create "substantial *opportunities* for improper cost allocation," and that "allowing the sharing of such services would require excessive, costly and burdensome regulatory involvement" to protect against that possibility. *Non-Accounting Safeguards Order* ¶ 163 (emphasis added) (quotation marks and citation omitted). Accordingly, the Commission decided to restrict the further sharing of OI&M services as a way to protect against the possibility that it could result in such significant misallocation of costs as to create "the *opportunity* for . . . substantial integration of operating functions [that could] preclude independent operation." *Non-Accounting Safeguards Order* at 21984 ¶ 163 (emphasis added). Significantly, however, the Commission itself recognized that restricting the sharing of OI&M services was not the *only* way to protect against that possibility, and that other regulatory safeguards also could protect against potential cost misallocations. The Commission simply determined, after balancing what it perceived at the time to be the relative benefits and burdens of the different options, that it preferred the OI&M rule to the alternatives.

c. Seven years of experience with the BOCs' sharing a variety of services with their affiliates now have shown that, whatever the merit of the balance originally struck by the Commission, the OI&M rule is not needed today to safeguard against improper cost allocation or integration of operations by the BOCs. As the Commission recognized even in 1996, "nondiscrimination safeguards, the biennial audit requirement, and other public disclosure requirements imposed by section 272" limit the opportunities for integration, and generally make blanket prohibitions on sharing unnecessary.[3/] *Non-Accounting Safeguards Order* at 21986 ¶ 167. These protections have proven sufficient to prevent improper integration and cost allocation with respect to the services that BOCs have been permitted to share with their affiliates, and they would be equally effective with respect to shared OI&M services.

Further, the passage of time has reduced any risk of cost misallocation, and that decisively tips the balance back in favor of permitting sharing: While, as a general matter, there is little incentive to misallocate costs to regulated accounts under price caps, the Commission severed any remaining links between prices and costs when it eliminated sharing from price caps and when it adopted the CALLS structure. At the same time, the development of competition in all segments of the market limits the BOCs' incentive to raise prices for one service in order to recover the costs of another.

The Commission has recently recognized in a similar context that the passage of time may prove that a protection put in place in anticipation of competitive risks has been rendered unnecessary. As the Commission concluded in its recent order terminating the rulemaking on the implementation of the separate affiliate requirements for BOCs' manufacturing of telephone equipment, "the benefit of hindsight" may prove the Commission's previously articulated concerns "unwarranted because the competitive harms the Commission envisioned simply have

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3/ For example, sections 272(b)(2)-(5) impose structural and transactional restrictions on Verizon's 272 separate affiliate; section 272(c) requires Verizon to comply with specified nondiscrimination safeguards.

not materialized."[4/] Likewise, here, there is no risk that allowing BOCs and their affiliates to share OI&M services would lead to a violation of section 272(b)(1): experience has shown that other regulatory protections eliminate both the incentives and the opportunities to engage in improper cost allocation and integration. The OI&M rule thus not only is not *required* under section 272(b)(1); it also is entirely unnecessary to serve the public interest.

d. AT&T's sole response to this point is to insist that *all* regulations are necessarily "requirements" of the Act. *See* Letter from David Lawson, Sidley Austin Brown & Wood, to Marlene Dortch, Secretary, FCC, at 8 (filed July 9, 2003) ("*AT&T ex parte*"). But the handful of quotes that AT&T cites in support of that assertion fall woefully short. AT&T's citation to section 252(e)(2)(B) shows only that where Congress intended for regulations to be included within a reference to statutory "requirements," it specifically so provided. The provision requires compliance with "the requirements of section 251," and expressly specifies that for that purpose, requirements "includ[e] the regulations prescribed by the Commission pursuant to section 251." 47 U.S.C. § 252(e)(2)(B).[5/] Nor is there any basis for AT&T's suggestion that the Commission "recognized," in the *1998 Biennial Review*,[6/] "that the term 'requirement' in section 10(d) applies to . . . 'implementing regulations.'" *AT&T ex parte* at 8 (citation omitted). To the

4/ Memorandum Opinion and Order, *Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996*, CC Docket No. 96-254, FCC 03-220 ¶ 6 (rel. Sept. 16, 2003).

5/ AT&T's citation to section 251(b)(2) is similarly unavailing. *See AT&T ex parte* at 8. There, Congress referred to "requirements prescribed by the Commission." 47 U.S.C. § 251(b)(2). But this reference to regulatory requirements provides no insight to section 10(d)'s reference to requirements of specific statutes.

6/ Notice of Inquiry, *1998 Biennial Review - Testing New Technology*, 13 FCC Rcd 21879, (1998).

contrary, the Commission simply noted there that it was not proposing to forbear either from the provisions of sections 251 or 271, "or from the regulations implementing" them.[7] It never suggested that these were the same thing.

2. Second, in addition to the fact that the OI&M rule is not required by section 272 to begin with, the narrow limitation on the Commission's forbearance authority set out in section 10(d) cannot reasonably be read to incorporate *sub silencio* the requirements of section 272.

a. As an initial matter, section 10 was a broad grant of new authority to the Commission that was designed to further the Act's deregulatory purposes.[8] Congress's adoption of section 10 was in part a response to court decisions limiting the Commission's implicit forbearance authority. *See, e.g., MCI Telecomms. Corp. v. FCC,* 765 F.2d 1186, 1191-96 (D.C. Cir. 1985) (finding that Commission lacked authority to order mandatory detariffing and that authority to depart from the Act in that manner required congressional authorization). Section 10 accordingly gave the Commission explicit and sweeping authority to forbear from most requirements of the Act. In fact, section 10 provides that as a general matter, the Commission *must* forbear, both from its own rules and from requirements of the Act. 47 U.S.C. § 160(a) (providing that the Commission "*shall* forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service" if the conditions for forbearance are satisfied) (emphasis added).

7/ *Id.* ¶ 32.

8/ *See* 141 Cong. Rec. S7787 (1995) (Sen. Pressler's statement that "the legislation permits the FCC to forbear from regulating carriers when forbearance is in the public interest. This will allow the FCC to reduce the regulatory burdens on a carrier when competition develops, or when the FCC determines that relaxed regulation is in the public interest.").

There is one narrowly defined limitation to the Commission's broad forbearance authority, and even that exception applies only for a limited period of time. Section 10(d) precludes the Commission from forbearing only "from applying the requirements of section 251(c) or 271" -- two provisions of the 1996 Act that are specifically designed to open the previously closed local markets to competition. 47 U.S.C. § 160(d). And even as to these provisions, the limitation on the Commission's forbearance authority applies only for a limited period of time -- namely, "until [the Commission] determines that those requirements have been fully implemented." *Id.*

b. Section 10(d) should be afforded the most natural reading of its plain terms: that the Commission's forbearance authority is limited only with respect to the two provisions expressly identified in that section. The Commission should reject the CLECs' argument that section 10(d) reaches section 272 as well through the reference to section 272 in section 271(d)(3). Such a daisy chain interpretation of section 10(d)'s scope would require reaching out to expand an exception that Congress deliberately drafted narrowly.

Basic principles of statutory construction compel the plain reading of the statute over a contorted one: As the courts have explained, "Rather than adopt a contorted interpretation of crystal clear statutory language," proper statutory interpretation requires "accepting that the legislature means what it says. . . ." *Scott v. Snelling and Snelling, Inc.*, 732 F. Supp. 1034, 1040-41 (N.D. Cal. 1990). Because Congress here specified only two exceptions to the Commission's section 10(a) forbearance authority, the statute on its face precludes the addition of other exceptions. *See United States v. Johnson*, 529 U.S. 53, 58 (2000) ("When Congress provides exceptions in a statute, . . . [t]he proper inference, . . . is that Congress considered the issue of exceptions and, in the end, limited the statute to the ones set forth."); *see also Tang v. Reno*, 77

F.3d 1194, 1197 (9th Cir. 1996) (item "omitted from a list of exclusions is presumed not to be excluded") (quotation omitted); *Herzberg v. Finch*, 321 F. Supp. 1367, 1369 (S.D.N.Y. 1971) ("As a general rule, where a statute makes certain specific exceptions to its general provisions, it is generally safe to assume that all other exceptions were intended to be excluded.") (quotation omitted).

Finally, there is no merit to AT&T's argument that the specific sunset instructions for section 272 compel a different reading of section 10(d). AT&T suggests that the sunset provision in section 272(f) illustrates that sunset is the *only* means that Congress provided for eliminating section 272, and thus supports a reading of section 10(d) that would reach section 272 through section 271. *See AT&T ex parte* at 3. But several other provisions of the Act contain sunset provisions, and these clearly are not covered by the section 10(d) limitation. *See, e.g.*, 47 U.S.C. § 274(g)(2) (electronic publishing); 47 U.S.C. § 273(d)(6) (manufacturing safeguards). The sunset provisions in section 272 impose no more of a constraint on the Commission's forbearance authority.

c. Even if there were any ambiguity about the meaning and reach of section 10(d), there are good reasons to interpret it as being limited to sections 251(c) and 271 rather than as sweeping in section 272 or any other provision of the Act. Sections 251 and 271 are designed to open local markets to competition. Section 272, in contrast, comes into play only if and when the markets have been opened. The Commission has always recognized that regulatory safeguards of this type should be pursued through tools that may be adjusted as the market changes, as markets constantly do.[9/] And, as Congress recognized, where there is evidence that

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[9/] *See e.g.*, Further Notice of Proposed Rulemaking, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, 18 FCC Rcd 10914, ¶ 8 (2003) (noting that the

the market can operate and police itself without the blunt instrument of regulation, regulation should be reduced and eliminated. *See, e.g.,* 141 Cong. Rec. H8275 (daily ed. Aug. 2, 1995) (Rep. Paxon) (preferring competition to regulation).

Thus, it makes perfect sense for Congress to provide that, once enforcement of sections 251(c) and 271 has opened local markets to competition, the Commission should forbear from applying any requirements (including section 272) if a forbearance petition meets the multi-part forbearance test under section 10. Of course, the fact that the Commission *may* forbear from section 272 does not mean it *must:* forbearance will turn on whether, under current market conditions, individual section 272 regulations have become unnecessary.

d. Finally, even if it were possible to read section 10(d) to sweep in some type of requirement that is related to section 272, and for the reasons we explain above -- even separate and apart from the fact that the OI&M rule is not required by section 272 to begin with -- it is not, such an incorporation by reference would not preclude the relief requested here. Section 271 requires a BOC to show it will comply with section 272 in its provision of the authorized services, *see* 47 U.S.C. § 271(d)(3)(B), and that showing can only be of section 272 obligations as the Commission has interpreted that provision *at the time of the BOC's application.* Thus, if the Commission amends or forbears from its regulations or any requirements of section 272, a BOC's obligations -- and the necessary showing it would have to make with respect to section 272 -- would be amended accordingly.

Commission's "regulatory response must be guided by a full understanding of the existing market dynamics" and acknowledging significance of "changes in the competitive landscape.").

In each of its states, Verizon made the necessary showing that it did and would comply with section 272 as interpreted by the Commission at the relevant time. That showing included compliance with OI&M rule. If the Commission had amended its section 272 rules *prior* to Verizon's 271 applications so as to eliminate the OI&M rule, Verizon would not have had to make that showing to demonstrate its compliance with the requirements of section 271. Likewise, the Commission can now forbear from the OI&M rules, without affecting the general 271 requirement that BOCs comply with section 272. As the Commission has recognized, compliance with the requirements of section 271 is determined consistent with changes in the law.[10]

3. Third, as noted above, the narrow exception to the Commission's forbearance authority with respect to the requirements of section 271 (however construed) applies only for a limited period. That limitation expires as soon as the Commission "determines that those requirements have been fully implemented." 47 U.S.C. § 160(d).

While the Commission need not reach this issue to resolve the questions presented here, Verizon necessarily has fully implemented the requirements of section 271 given the grant of each of Verizon's section 271 applications for long distance authority. Section 271 allows the grant of an interLATA authorization only if the Commission finds that a BOC has "fully implemented" the section 271 checklist. 47 U.S.C. § 271(d)(3)(A)(i). Thus, while the provisions

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[10] *See, e.g.*, Memorandum Opinion and Order, *Application of SBC Communications Inc. for Authorization to Provide In-Region InterLATA Services in Texas*, 15 FCC Rcd 18354 ¶ 29 (2000) ("*Texas 271 Order*") (for purposes of obtaining section 271 authorization, a BOC must "demonstrate that it is [at the time it files its 271 application,]currently in compliance with the rules in effect on the date of filing."); *id.* ¶ 32; Memorandum Opinion and Order, *Application by Bell Atlantic New York for Authorization under Section 271 of the Communications Act to Provide In-Region, Interlata Service in the State of New York,* 15 FCC Rcd. 3953, ¶ 31 (1999) ("*New York 271 Order*").

of section 271 may be "fully implemented" earlier, a grant of section 271 relief clearly comprises a finding of "full implementation" for purposes of section 10(d). Reading the "fully implemented" language of section 10(d) in conjunction with identical language in section 271 comports with the Supreme Court's "adopt[ion] [of] the premise that [a] term should be construed, if possible, to give it a consistent meaning throughout the Act." *Gustafson v. Alloyd Co.*, 513 U.S. 561, 568 (1995) (interpreting the term "prospectus" as used in multiple provisions of the Securities Act of 1933). Indeed, if a finding that a BOC has satisfied section 271 does *not* amount to full implementation, it is unclear what *could* qualify, and what rational, achievable meaning section 10(d)'s reference to full implementation possibly could have.[11/]

Nor is forbearance from applying the OI&M rule in any way inconsistent with the Commission's authority to continue to enforce the "conditions required for [271] approval" under section 271(d)(6) of the Act. The Commission consistently has recognized that for purposes of obtaining section 271 authorization, a BOC must be in compliance with the law in effect at the time of its application but, once the BOC obtains section 271 authorization, its continued compliance is measured by current statutory and regulatory requirements. *See, e.g., Texas 271 Order* ¶¶ 29, 32; *New York 271 Order* ¶ 31.

Of course, this does not mean that the Commission must forbear from applying section 271 (or section 272) to a BOC at the moment the BOC obtains relief under section 271. Whether forbearance is proper is a distinct question from whether it is permissible. A petitioner must

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11/ *See Rosado v. Wyman*, 397 U.S. 397, 415 (1970) (noting the "basic axiom [ ] that courts should construe all legislative enactments to give them some meaning"); *Qi-Zhuo v. Meissner*, 70 F.3d 136, 139 (D.C. Cir. 1995) ("An endlessly reiterated principle of statutory construction is that all words in a statute are to be assigned meaning, and that nothing therein is to be construed as surplusage.").

show that its request for forbearance meets the three-pronged test set forth under section 10(a). Implementation of section 271 does not necessarily mean that test is satisfied. But here, Verizon has made a clear showing that the section 10(a) test is fully satisfied.

Conclusion

In sum, the Commission has authority to forbear from applying the OI&M rule to Verizon.

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October 14, 2003

Ex Parte

Marlene H. Dortch
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Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules,* CC Docket No. 96-149; *Verizon Petition for Forbearance ,* CC Docket No. 01-338; *Review of Section 251Unbundling Obligations of Incumbent Local Exchange Carriers,* CC Docket No. 01-338; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* CC Docket No. 96-98; and *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 98-147, *Separate Affiliate Requirements in Connection with 1+ Calls from Payphones,* WC 02-200

Dear Ms. Dortch:

Today, Ed Shakin and Lynn Charytan represented Verizon in a meeting with Linda Kinney, John Stanley, Jeff Dygert, Paula Silberthau and Ann Bushmiller of the Office of General Counsel regarding the above proceedings. The positions presented by Verizon were consistent with those filed in the record of these proceedings and with the attached previously filed paper.

Specifically discussed was the fact that the requirements of section 271 are "fully implemented" for purposes of section 10(d) of the Act in a state at the Commission approves a section 271 application. Indeed, section 271 specifically obligates the Commission to find that the checklist requirements are "fully implemented" as a prerequisite to granting a section 271 authorization, 47 U.S.C. § 271(d)(3)(A)(i). By contrast, section 272 cannot be read to impose a three-year window prior to which the Commission may not find that the requirements of section 271 have been fully implemented. Doing so is inconsistent with the language, structure and intent of the relevant provisions. In addition to the fact that the terms of section 271 itself provide the answer to the question of when the requirements of that section are "fully implemented," it would make no sense to read compliance with section 272 as "implementing" section 271: the two are distinct provisions that serve distinct purposes. Section 272 is triggered only *after* the Commission has found that a BOC has satisfied section 271 and is in the long distance market. As noted, section 271 itself is implemented when the Commission finds that the "requested authorization *will* be carried out in accordance with the requirements of section 272" 47 U.S.C. § 271(d)(3)(B). Thereafter, the requirement to continue to comply with section 272 is a requirement of section 272 itself – not section 271. Even if section 10(d) were erroneously construed to reach and therefore limit the Commission's forbearance authority with respect to section 272 – a result that is inconsistent with section 10(d)'s specific reference to only sections 271 and 251(c) and not section 272 – it would make no sense to link a determination that section 271 has been fully implemented back to the section 272 sunset. Indeed, if that were the case, it would create a catch-22: section 10(d)'s full implementation language would never apply to permit forbearance with respect to section 272, because the 10(d) forbearance limitation would last until the statutory obligation under section 272 simply dissolved by force of law. In other words, as long as section 272 was in effect, it could not be fully implemented. This interpretation would deprive the Commission of all forbearance authority with respect to section 272 and render the "full implementation" exception to section 10(d) a nullity with respect to that provision – thus limiting the Commission's forbearance authority *entirely* with respect to a provision that is not even explicitly referenced in section 10(d) at all.

Please feel free to call me if you have any questions.

Sincerely,

Dee May

cc: John Rogovin
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October 27, 2003

Ex Parte

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Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149

Dear Ms. Dortch:

AT&T's September 16, 2003 and October 1, 2003 ex parte filings demonstrate nothing more than its continuing attempts to create confusion about Verizon's petition for forbearance. Verizon has already explained how it would comply with the Commission's cost accounting rules and non-discrimination requirements if the Verizon local exchange carriers were permitted to share operating, installation, and maintenance ("OI&M") services with their section 272 affiliates. AT&T simply misinterprets Verizon's proposals. The sharing of these services would be no different than the sharing of other services already permitted. AT&T also continues to criticize Verizon's demonstration of the cost savings that Verizon could achieve if it could share OI&M services between the Verizon BOCs and their section 272 affiliates, despite the extensive documentation that Verizon has already placed in the record. Verizon has already addressed most of these issues and will limit its response accordingly.

First, AT&T's primary complaint about Verizon's OI&M petition is an irrelevancy. AT&T argues that the OI&M restriction does not hinder Verizon in the long distance market, because Verizon has already obtained a 34 percent market share in New York despite the restriction. ***See*** AT&T Oct. 1 ex parte, 1-2. This reveals that AT&T's opposition is not based on legitimate concerns of abuse but rather that it is based on the fact that Verizon has just been too successful in providing customers a competitive alternative to AT&T's long distance services. AT&T's argument that the Commission should continue to burden Verizon with the costs of the OI&M restriction is a simple plea for protectionism. It contradicts the Commission's firm adherence to the principle that its goal under the Act is to "protect *competition* in the relevant market, not particular *competitors*." *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 14 FCC Rcd 10771, ¶ 38 (1999). Moreover, the market share that

AT&T points to is the mass market, where Verizon has offered attractive options that appeal to low volume customers. If AT&T wants to be more successful in this market, it should concentrate on meeting consumer needs rather than trying to place regulatory hindrances on its competitors.

Second, AT&T claims that Verizon would use the "prevailing market price" standard for affiliate transactions under section 32.27(c) of the Commission's rules to avoid charging the section 272 affiliates the full market value of OI&M services above and beyond the costs of providing the services. ***See*** AT&T Sept. 16 ex parte, 1; AT&T Oct. 1 ex parte, 5-6. It is not clear whether AT&T has a problem with Verizon's proposal or with the Commission's rule, which allows a local exchange carrier to book revenues for services to a section 272 affiliate at prevailing market price. The Commission adopted this rule because "the rates for services subject to section 272 must be made generally available to both affiliates and third parties . . . ." *Accounting Safeguards Order*, 11 FCC Rcd 17539, ¶ 137 (1996). Therefore, Verizon could not give its section 272 affiliates any cost advantage, because any "prevailing market price" that it charges the section 272 affiliate for OI&M services would have to be extended to other interexchange carriers as well. AT&T argues that the sharing of OI&M services would save money only if the local exchange carrier's costs would be lower than the prices that the section 272 affiliate would pay to third party vendors for such services. ***See*** AT&T Sept. 16 ex parte, 2. But, consistent with the Commission's expectations, such efficiencies would benefit the entire market. If Verizon's prevailing market prices for OI&M services were lower than what AT&T could obtain from third party vendors or were lower than the costs that AT&T would incur to provide such services to itself, it would be free to purchase those services from Verizon at the same rates.

AT&T claims that Verizon structures its affiliate transactions to make this unlikely, citing as an example Verizon's offer of large discounts on billing and collection services only if a customer provides 85 percent of its total Verizon end user billing to Verizon for processing. AT&T claims that the only carriers that would qualify for such discounts are Verizon's section 272 affiliates, but this is just wrong. Verizon has over a dozen unaffiliated customers who have chosen to take advantage of these discounts. Some carriers, like AT&T, may have other reasons for taking back the billing and collection function, such as a desire to minimize Verizon's contact with their customers, that outweigh the attractiveness of these discounts. However, Verizon has structured these discounts so that any carrier can qualify, since the discounts are based on how much of its own billings each carrier commits to Verizon's billing and collection services.

AT&T also claims that Verizon's explanation of how it would track the costs for these services does not give the Commission the tools it would need to detect and deter misallocations of costs. However, there is no reason why cost tracking for OI&M services would be any different than for other nonregulated services, such as inside wire maintenance, which Verizon has provided for years pursuant to cost allocation procedures described in its Cost Allocation Manual ("CAM"), and which has been reviewed by the Commission staff. AT&T claims (Oct. 1 ex parte, 6-7) that CAM accounting would not be an effective regulatory safeguard, because it would require "excessive, costly and burdensome" audits. AT&T must be unaware that the Commission already requires the CAM to be audited on a biennial basis. These audits would provide the Commission staff with the ability to monitor the actual allocation of OI&M costs pursuant to the CAM.[1]

Third, AT&T argues that if Verizon began using the local exchange carrier's operating support systems ("OSSs") to provide services to the section 272 affiliates, they would have to give unaffiliated carriers the same access to these OSSs, something that Verizon has refused to do in the past. ***See*** AT&T Sept. 16 ex parte, 2; AT&T Oct. 1 ex parte, 8-9. AT&T is utterly confused. AT&T fails to distinguish between the local exchange carrier's use of its OSSs to provide exchange access services and its potential use of some of those OSSs to provide OI&M services to the long distance networks of the section 272 affiliates or of unaffiliated carriers. To the extent that the local exchange carrier uses its OSSs to provide exchange access services, it will continue to do so on a nondiscriminatory basis to fulfill orders for access services from all carriers, and neither the section 272 affiliates nor any other carriers will have access to the local exchange carrier's information in those OSSs. If the local exchange carriers also use some of these OSSs to operate, install and repair the long distance networks of the section 272 affiliates or of other carriers, the section 272 affiliates and other carriers would only have access to data about their own networks in those OSSs.

There is no operational reason why Verizon should maintain separate OSSs for the local exchange network and for the long distance network. Verizon built separate OSSs for the section 272 affiliates solely because of the OI&M restriction. ***See*** Verizon June 4, 2003 ex parte, Attachment 3, p. 2. As Verizon demonstrated in its forbearance petition, this unnecessary duplication of costs is especially harmful as Verizon begins to deploy the next generation network and moves into a broadband environment. ***See*** Verizon Petition, 5, Declaration of Jeannie H. Diefenderfer. One example is packet switched services such as Frame Relay and ATM services offered to enterprise business customers. AT&T and MCI dominate this segment of the market, and the restrictions placed on Verizon place it at a significant disadvantage as it tries to compete with those companies. While those companies can and do provide services on a fully integrated basis, the OI&M rules require Verizon to maintain separate work forces and systems for the local and long distance components of its services. This adds inefficiency, cost, and operational complexities that those companies do not bear, and that harm competition.

The same is true of next-generation networks. The OI&M rules would require separate work forces and systems to operate the local and long distance components of these new networks, even though the rational and efficient way to do so in many instances would be to share the necessary services. As a result, the OI&M rule adds inefficiency, cost and operational complexities to these new networks as well. The result is to undermine the business case for deploying these networks, as well as to add to the cost and jeopardize the quality of the services provided over them.

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[1] AT&T argues that audits are ineffectual, citing the recent Notice of Apparent Liability concerning Verizon's first section 272 audit. However, the section 272 audit report, together with the audit workpapers, provided the Commission with extensive data to evaluate Verizon's compliance with the section 272 safeguards. Moreover, as Verizon demonstrated in its Oct. 8, 2003 response to the NAL, the matters raised in the NAL do not constitute material violations of the Commission's rules.

Verizon's petition is designed to eliminate such wasteful duplication of costs. Nonetheless, Verizon has repeatedly explained that, if it were permitted to share OI&M services, it would not be cost effective to abandon the investment in OSS systems that the section 272 built to comply with the OI&M separation rule. This is why Verizon's projected savings for OSS if forbearance were granted are relatively small, especially in the early years. If forbearance were granted, over time Verizon would use enhancements to the local exchange carrier OSSs to provide OI&M services to the section 272 affiliates rather than to continue to invest in separate OSS systems, and this would generate synergy savings. However, this does not mean that Verizon would give the section 272 affiliates, or any unaffiliated carriers that purchased OI&M services from the local exchange carriers, access to the local exchange carrier's OSSs for the provision of exchange access services.

Fourth, AT&T disagrees with Verizon's explanation that the local exchange carrier would incur some amount of additional costs to provide OI&M services to the section 272 affiliates, claiming that this is inconsistent with Verizon's statements in its June 24 ex parte filing that the local exchange carrier would absorb these services using its existing staff. ***See*** AT&T Sept. 16 ex parte, 2-3. However, if Verizon had thought that the local exchange carrier could absorb these services without *any* additional cost, it would not have estimated that only a portion of the section 272 affiliate's costs could be saved without the OI&M restriction – it would have assumed that *all* of those costs could be avoided. However, as explained in Verizon's June 4 ex parte filing, Verizon estimated that it would save about 30 percent of the section 272 affiliate's workforce expenses because "the BOC employees could have handled the additional work on the long distance network with fewer *additional* employees than GNI due to economies of scale." Verizon June 4, 2003 ex parte letter, Attachment 3, 3 (emphasis added). Verizon clearly assumed that the local exchange carrier would experience additional costs in providing OI&M for the long distance network, but that it could perform these functions more efficiently than the section 272 affiliates.

Finally, AT&T argues that price cap regulation does not remove any incentive for the Verizon local exchange carrier to misallocate costs, because market forces are not likely to constrain prices by the time that the CALLS plan expires in 2005 and that Verizon could use inflated costs to support higher access charges at that time. ***See*** AT&T Sept. 16 ex parte, 4; AT&T Oct. 1 ex parte, 7-8. This is piling speculation on speculation. Competition is growing steadily, as evidenced by the continuing *decline* in demand for Verizon's local exchange and exchange access services. Verizon has lost 12 million retail telephone lines in the last three years, and minutes of use on Verizon's retail services declined by 7 percent in the last quarter alone.[2] This intense competition will provide a far more effective control over prices in the future than regulation. Furthermore, the idea that Verizon would seek to return to cost-based rate regulation is fanciful – Verizon has been steadfast in its support of price-based regulation as a transition to market-based rates. Verizon has no desire to turn the clock back to rate-of-return.

These continued attacks are running in circles. Verizon has explained its proposal numerous times and has answered all questions about how it would track the costs for OI&M services and how it would continue to provide access services for both its section 272 affiliates and for

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2 ***See*** http //investor.verizon.com/financial/

unaffiliated carriers on a non-discriminatory basis. The Commission should approve Verizon's forbearance petition and permit Verizon to pass along to the public the benefits of increased efficiencies.

Please feel free to call me if you have any questions.

Sincerely,

Ann D Berkowitz

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October 30, 2003

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Re: *Petition of Verizon for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules*, CC Docket No. 96-149

Dear Commissioner Adelstein:

This provides additional information to show that, if the Commission granted Verizon's petition for forbearance from the prohibition on the sharing of operating, installation, and maintenance ("OI&M") functions between the Verizon local exchange carriers and their section 272 affiliates, Verizon would perform these functions in compliance with the Commission's cost accounting and section 272 separation rules and that it would produce substantial benefits.

First, the Commission's existing accounting rules would ensure that Verizon properly allocated the costs of OI&M services to the section 272 affiliates. Verizon already follows these rules for the sharing of services other than OI&M among the Verizon affiliates. *See Non-Accounting Safeguards Order*, 11 FCC Rcd 21905, ¶¶178-186 (1996); 47 C.F.R. § 32.27. If granted OI&M relief, Verizon would modify its Cost Allocation Manual and it would develop time reporting codes to record OI&M work done for the section 272 affiliates. This would be subject to the biennial audit of Verizon's Cost Allocation Manual.

Second, OI&M activities by the local company on behalf of long distance affiliates would be subject to the biennial audit under section 272(d) of the Act. Verizon has already conducted two biennial audits. The audit reports provided a large volume of data to show that Verizon has complied with the section 272 rules. Although the Enforcement Bureau recently issued a Notice of Apparent Liability concerning three items in the first audit report, Verizon's response shows that none of the matters in the Notice constitute material violations of the Commission's rules. The fact that only a small number of insignificant matters were raised out of the large volume of data tested by the auditors shows that Verizon has an effective system of internal controls for complying with the section 272 rules.

Third, approval of Verizon's forbearance petition would produce substantial public benefits. Verizon would be able to save approximately $183 million in costs over the 2003 – 2006 time period by eliminating duplicative costs and inefficiencies caused by the OI&M restriction. ***See*** Verizon June 4, 2003 ex parte letter, Attachment 4. Without approval of the petition, these costs ultimately would be borne by consumers in the form of lower competition, higher prices and reduced innovation.

Fourth, approval of the petition would allow Verizon to send more work to the local exchange carriers' workforce rather than force it to continue to use expensive outside contractors. Of the $183 million in projected savings, $39 million would come from shifting outside contractor work to employees at the Verizon local exchange carriers. Use of these experienced and highly skilled employees to perform the same type of work for the long distance companies that they provide for the local exchange would ensure quality service to the public.

Sincerely,

Kathryn C. Brown

cc Lisa Zaina
Chris Libertelli
Dan Gonzalez
Matt Brill
Michelle Carey
Jeff Carlisle
William Maher